

Message Text

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TO SECSTATE WASHDC 3537

C O N F I D E N T I A L SECTION 1 OF 2 HONG KONG 0681

E.O. 11652: GDS

TAGS: ECON PGOV HK

SUBJ: HKG SEEMS TO BE LOSING ITS SNAP; OR, IS
THE ENGLISH DISEASE CATCHING?

SUMMARY: AFTER TWO DECADES OF HEADY ECONOMIC EXPANSION,
WITH FEW INTERRUPTIONS, HONG KONG IS FACED WITH STAGNATION
STEMMING FROM DEPRESSED ACTIVITY IN ITS PRINCIPAL MARKETS
AND RESULTING MASSIVE UNEMPLOYMENT. ALTHOUGH LAISSEZ-
FAIRE IS THE PHILOSOPHY PROFESSED (IF NOT ALWAYS FOLLOWED)
BY THE HG AND PREFERRED BY THE MORE ARTICULATE MEMBERS
OF THE ESTABLISHMENT, THERE ARE SIGNS THAT THE PUBLIC
AT LARGE EXPECTS THE GOVERNMENT TO BE DOING MORE THAN
POINTING TO THE GRACEFUL SYMMETRY OF THE MODELS OF
CLASSICAL ECONOMICS. FOR ITS PART, THE GOVERNMENT SEEMS
TO BE ALL THUMBS AND THE RECENT DEBACLE OF THE MASS
TRANSIT CONTRACT IS ONLY THE LATEST IN A SERIES OF EVENTS
THAT HAVE TURNED OUT BADLY FOR THE HKG. SINCE ECONOMIC
POLICY IS LARGELY IDENTIFIED WITH THE FINANCIAL SECRETARY,
IT IS NOT SURPRISING THAT SOME ARE ALREADY CALLING FOR
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HIS HEAD. THE HKG APPEARS TO HAVE ENTERED A VERY ROUGH

PERIOD-- WHAT COULD BE CONSIDERED AS MERELY ERRORS IN JUDGEMENT ARE SEEN AGAINST A BACKGROUND OF PERVERSIVE CORRUPTION-- AND THE PAST PERFORMANCE OF THE GOVERNMENT INFORMATION SERVICE DOES NOT LEND MUCH HOPE THAT THESE EVENTS WILL BE PERCEIVED IN THE BEST POSSIBLE LIGHT. THE STOCK IN TRADE OF BRITISH COLONIAL REGIMES HAS BEEN THEIR MYSTIQUE OF OMNISCIENCE AND UNFLAPPABILITY. THE HKG IMAGE IS IN DANGER OF SINKING INTO ONE OF IGNORANCE COMBINED WITH CORRUPTION. THIS CABLE DISCUSSES THE HKG'S ECONOMIC AND ATMOSPHERIC PROBLEMS. A POLITICAL ASSESSMENT FOLLOWS BY SEPTTEL. END SUMMARY.

1. ECONOMIC INDICATORS - BAD NEWS: HKG STATISTICS PUBLISHED IN EARLY JANUARY HAVE CATALOGUED A FLOW OF BAD NEWS. NOVEMBER 1974 EXPORTS WERE DOWN BY 6.4 PERCENT, IN VALUE, FROM A YEAR AGO. GIVEN THE INTERVENING INFLATION THE VOLUME FIGURES WHEN CALCULATED WILL BE MUCH WORSE. (THE FIRST THREE QUARTERS WHICH REGISTERED A VALUE INCREASE OF 30 PERCENT SAW A VOLUME DROP OF 1.57 PERCENT.) SEPTEMBER EMPLOYMENT FIGURES WERE DOWN BY 123,000 (4 PERCENT) FROM JUNE. THE OCTOBER HKG ACCOUNTS SHOWED A CUMULATIVE DEFICIT OF HK\$980 MILLION (US\$200 MILLION). TOURIST ARRIVAL FIGURES REVEALED NO GROWTH IN 1974. THE NOVEMBER COL INDEX WAS 15 PERCENT ABOVE DECEMBER 1973.

2. OF THESE STATISTICS, UNEMPLOYMENT IS THE MOST SERIOUS. REGISTERED INDUSTRIAL EMPLOYMENT DROPPED BY 51,000 BETWEEN SEPTEMBER 1973 AND SEPTEMBER 1974; THE DROP IN UNREGISTERED EMPLOYMENT IS ESTIMATED TO BE MORE SEVERE. INFLATION STATISTICS ARE MISLEADING, OWING TO SHARP SEASONAL FLUCTUATIONS IN FOOD PRICES. HAD THESE NOT BEEN UNUSUAL TYPHOONS AND RAIN IN OCTOBER AND NOVEMBER, WHICH DISRUPTED FOOD DISTRIBUTION THE COL INDEX WOULD HAVE BEEN IN THE NEIGHBORHOOD OF 10 PERCENT. REAL HOURLY WAGES, HENCE, ARE NOT DECLINING AS THEY WERE A YEAR AGO, BUT REAL INCOME IS DECLINING THROUGH UNEMPLOYMENT AND SHORTER WORK WEEKS. THE MOST OPTIMISTIC PREDICTIONS FOR AN UPTURN IN HONG KONG'S MARKETS IS SIX MONTHS HENCE; MOST OBSERVERS, HOWEVER, BELIEVE IT WILL TAKE AT LEAST ONE YEAR. GIVEN EXTRADINARY CROWDING, CONFIDENTIAL

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PROLONGED UNEMPLOYMENT CARRIES A DISTINCT RISK OF SOCIAL UNREST. WE PROBABLY WOULD HAVE SEEN OUTBURSTS BY NOW HAD IT NOT BEEN THE POLICY OF LEFT WING UNIONS TO " COOL IT".

3. GOVERNMENT POLICIES-- MOUNTING CRITICISM: THERE HAS BEEN STRONG CRITICISM OF THE HKG'S POLICY OF KEEPING MOST OF ITS RESERVES IN STERLING INSTRUMENTS, UNTIL QUITE RECENTLY, A POLICY ALLEGED TO HAVE COST SOME HK\$2 BILLION.

THIS FIGURE IS OPEN TO DISPUTE AND IS PARTLY A MATTER OF BOOKKEEPING. AT ANY RATE, THE CONGEN BELIEVES HKG DID NOT ENJOY MUCH FREEDOM OF ACTION IN THIS MATTER UNTIL JUST BEFORE THE EXPIRATION OF THE STERLING GUARANTY. AMONG INDUSTRIALISTS, THERE HAS BEEN EQUALLY STRONG CITICISM OF THE HKG NOVEMBER DECISION TO FLOAT ITS CURRENCY. BY RAISING US DOLLAR COSTS OF ITS EXPORTS AND INTRODUCING UNCERTAINTIES INTO CONTRACTS, THE FLOAT HAS CUT INTO ALREADY DEPRESSED EXPORTS TO THE US MARKET. ALTHOUGH QUASI-GOVERNMENT SOURCES HAVE SPREAD THAT CANARD THAT INTERVENTION IN LATE NOVEMBER TO MAINTAIN CENTRAL RATE JUST BEFORE THE FLOAT COST THE HKG HK\$200 MILLION, BANING SOURCES DOUBT THAT IT COST MORE THAN HK\$ 50 MILLION. PENDING GOVERNMENT POLICIES ARE ALSO UNDER FIRE; (1) SERIOUS TALK OF RAISING THE TAX RATE IS BEIING ROUTINELY DENOUNCED AT SERVICE CLUB LUNCHEON SPEECHES; (2) PROPOSED LEGISLATION TO CONTROL THE ACTIVITIES OF FINANCE COMPANIES IS CAUSING THEM TO TAKE ANOTHER LOOK AT THE BAHAMAS AND CHANNEL ISLANDS; (3) THE INTRODUCTION OF A LEGISLATIVE BILL TO INTRODUCE PAY-AS-YOU-GO TAXATION ON BUSINESS PROFITS HAS PRODUCTED A REACTION IN THE BUSINESS COMMUNITY THAT CAN BE DESCRIBED MOST CHARITABLY AS WILFUL COMPREHENSION; (4) APPLICATION BY THE TELEPHONE COMPANY TO RAISE ITS CHARGES BY 70 PERCENT HAS PROVOKED DENUNCIATIONS BY PROFESSIONAL GROUPS AND EVEN THE THREAT OF STUDENT DEMONSTRATIONS; (5) APPLICATION OBY THE STAR FERRY TO RAISE ITS CROSS HARBOR FARES HAVE EVOKED MEMORIES OF RIOTS IN 1966-- THE LAST TIME THE STAR FERRY DID THIS.

4. PLANS GONE AWRY: TWO MAJOR INVESTMENT PROJECTS HAVE COLLAPSED IN THE PAST WEEK --- THE OIL REFINERY AND THE MASS TRANSIT SYSTEM. THE HKG HAS RESERVED LAND ON LAMMA AND LANTAO ISLANDS FOR THE ERECTION OF AN OIL

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REFINERY AND PTROCHEMICAL COMPLEX BY PRIVATE INVESTORS. THE HKG HAS NO ILLUSIONS THAT THIS INVESTMENT WOULD CREATE MANY JOBS OR EVEN A SECURE SUPPLY OF SYNTHETIC FIBER FOR THE TEXTILE INDUSTRY. ITS PRINCIPAL INTEREST WAS IN THE CONCOMITANT STORAGE FACILITIES AND THEIR SUPPLY OF PETROLEUM PRODUCTS WHICH COULD BE COMMANDEERED IN AN EMERGENCY-- AN EMERGENCY SUPPLY FOR WHICH THE HKG WOULD NOT HAVE TO PAY STORAGE COSTS. ON JANUARY 7, THE SHELL/ DOW GROUP ANNOUNCED THE PRESENT ECONOMIC SITUATION PREVENTED THEM FROM SUBMITTING A PROPOSAL. ON JANUARY 16, THE REAMINING PRIVATE GROUP, A PARTNERSHIP BETWEEN THE TAO COMPANY OF JAPAN AND THE TEXTILE ALLIANCE (A JARDINES-SPONSORED COMBINATION OF TEXTILE PRODUCERS) ANNOUNCED THAT IT TOO WOULD HAVE TO SHELVE ITS PLANS INDEFINITELY.

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5. THE WITHDRAWAL OF THE JAPANESE CONSORTIUM FROM THE MASS TRANSIT CONTRACT (SEE HK 552) IS NOT MERELY A DIS-APPOINTMENT; IT CASTS DOUBT UPON THE INTEGRITY OF THE JAPANESE BIDDERS AND THE WISDOM OF THE HKG NEGOTIATORS. WHEN THE JAPANESE LETTER OF INTENT WAS ANNOUNCED LAST YEAR, LOCAL TAIPANS WHO HAD SUBMITTED UNSUCCESSFUL BIDS SAID IT WOULD BE IMPOSSIBLE TO CONSTRUCT THE SYSTEM, AS PROPOSED, WITHIN THE HK\$5 BILLION CEILING. THEY ARE NOT NOW RESISTING THE IMPULSE TO SAY, "I TOLD YOU SO". THE FACT THAT THE JAPANESE HAD FAILED TO STAY WITHIN COST ESTIMATES IN CONSTRUCTING THE SEOUL SYSTEM WAS A WARNING SIGN THAT APPARENTLY WENT UNHEEDED BY THE HKG. ONE ASPECT, WHICH HAS GIVEN RISE TO SEVERE CRITICISM, WAS THE LACK OF ANY FOREFEITABLE DEPOSIT OR PENALTY CLAUSE IN THE AGREEMENT WITH THE JAPANESE. THE CONSORTIUM MADE THE INSULTING OFFER OF A HK\$5 MILLION EX GRATIA PAYMENT AS COMPENSTATION, WHEREAS COSTS TO THE MASS TRANSIT AUTHORITY ARE ESTIMATED TO HAVE EXCEEDED HK\$100 MILLION. HTHE HG WOULD NOT LOOK SO BAD NOW, HAD IT REFRAINED IN THE PAST WHEN DOUBTS WERE RAISED PUBLICLY FROM ADOPTING

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THE TONE OF A KNOWING FATHER TRYING TO CALM THE
UNWARRANTED FEARS OF HIS CHILDREN.

6. THE BACKDROP OF CORRUPTION: CORRUPTION HAS BEEN A
FESTERING ISSUE FOR THE PAST FEW YEARS. IT HAD RECEIVED
ADDED IMPETUS FROM THE 1973 BLAIR-KERR REPORT
AND THE FLIGHT AND SUBSEQUENT EXTRADITION OF POLICE
INSEPECTOR PETER GODBER. A HIGHLY CRITICAL PAMPHLET WHICH
FOCUSED LARGELY ON CORRUPTION , "HONG KONG - A CASE TO
ANSWER" WAS CIRCULATED IN HONG KONG AND THE UK IN LATTER HALF
OF 1974. THE RESPONSE OF THE KG AND ESTABLISHMENT
LUMINARIES WAS A COLONEL BLIMP-ISH, "THOSE CHAPS DON'T
KNOW WHAT THEY ARE TALKING ABOUT". IN THE MEANTIME,
CORRUPTION HAS CONTINUED: FACTORY OWNERS COMPLAIN THEY
MUST PAY OFF LABOR INSPECTOR; THE MISSING HK\$10 MILLION
WHICH PROVOKED THE COLLAPSE OF THE PAUL LEE CO. (WHICH
HAS ONE-THIRD OF PWD CONSTRUCTION CONTRACTS) IS SAID BY
RELIABLE SOURCES TO BE LINING THE POCKETS OF PWD OFFICIALS;
GOVERNMENT EMPLOYEES IN SOME DEPARTMENTS ARE SAID TO HAVE
REQUESTED PAY RAISES ON THE BASIS THAT THEIR FIELD OF
WORK DOES NOT OFFER OPPORTUNITIES FOR TEA MONEY; A 1974
ISSUE OF THE FEER ESTIMATED THAT THE FUNDS INVOLVED IN
ILLEGAL ACTIVITIES AND PAY OFFS EQUAL ABOUT 10 PERCENT
OF THE GDP. THE INDEPENDENT COMMISSION AGAINST CORRUPTION
(ICAC), WHICH WAS ESTABLISHED AS AN INDEPENDENT ENTITY
BECAUSE IT WAS BELIEVED THAT THE POLICE DEPARTMENT WAS
TOO RIDDLED WITH CORRUPTION TO ROOT OUT CORRUPTION IN
GENERAL, HAS A WEAK IMAGE STEMMING FROM THE ALMOST
TRAIVIAL NATURE OF ITS CHARGES AGAINST GODBER; THIS IMAGE
WAS FURTHER TARNISHED RECENTLY WITH THE REVELATION THAT
ONE OF ITS INVESTIGATORS HAD BORROWED HK\$15,000 FROM A
POLICE SERGENT (HKS IS SO BLASE THAT NO ONE EVEN RAISED
THE QUESTION OF WHERE A POLICE SERGENT WOULD FIND
\$15,000 TO LEND). THE ISSUE HAS REACHED A NEW CRESCENDO
WITH THE APPEARANCE OF A SERIALIZED ACCOUNT BY CONVICTED
POLICE INSPECTOR ERNEST "TAFFY" HUNT OF HIS SYSTEMATIC
RAKE-OFFS SINCE 1956 WHICH RESULTED IN ACCUMULATED SAVINGS
OF HK\$5.5 MILLION. HUNT CLAIMS HE WAS ALWAYS ABLE TO
STAY ONE STEP AHEAD OF THE THEN POLICE ANTI-CORRUPTION
SQUAD THROUGH TIP-OFFS FROM ITS MEMBERS. IT IS ONE
THING FOR A GOVERNEMTN TO LOOK FOOLISH; IT IS FAR WORSE
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TO APPEAR BOTH FOOLISH AND CORRUPT.

7. THE GOVERNMENT IMAGE: THE CORRUPTION DESCRIBED ABOVE IS AT THE LOWER AND MIDDLE LEVELS OF DEPARTMENTS. NOONE BELIEVES , FOR EXAMPLE, THAT DEPARTMENT HEAD ARE ON THE TAKE (THEY ARE MORE NORMALLY COMPENSATED FOR ANY FAVORS RENDERED WITH DIRECTORSHIPS AND OTHER INNOCENT SINECURES AFTER RETIREMENT. THE UPPER LEVELS OF THE GOVERNMENT, HOWEVER, SUFFER FROM A SORT OF SCHIZOPHRENIA. ON ONE HAND, THE GOVERNOR DISPLAYS EARNEST CONCERN THAT GOVERNMENT MUST BE MORE RESPONSIVE AND MUST DO MORE TO IMPROVE THE QUALITY OF LIFE AND SECURE THE ECONOMIC AND SOCIAL VIABILITY OF THE COLONY. ON THE OTHER HAND, THE EX-MALAYA CIVILSERVICE AND "AFRICAN RETREADS" THAT PEOPLE THE UPPER ECHELONS PUSH FOR GOVERNMENT ON THE CHEAP WITH MOUNTING RESERVES TO GUARANTY THEIR PENSIONS. LAISSEZ-FAIRE IS NOT ONLY A PHILOSOPHY, IS IS AN EXCUSE FOR MINIMAL ACTION, EVEN IN BAD TIMES. THE PREVIOUS FINANCIAL SECRETARY HAD THE GOOD FORTUNE TO BE ABLE TO PREACH LAISSEZ-FAIRE DURING THE PERIOD OF UNINTERRUPTED GROWTH . THE CURRENT FS, WHO IS MORE OF AN ACTIVIST THAN HIS PREDECESSOR, HAS NOT ENJOYED THIS GOOD LUCK. PERHAPS MORE THAN ANY OTHER SENIOR OFFICIAL, HE HAS ADOPTED AN OLYMPIAN TONE WITH HIS CRITICS, PERENNIALY ACCUSING THEM OF NOT DOING THEIR HOMEWORK. IT IS NOT SURPRISING THAT THE NEW OF HUGE RESERVE LOSSES HAS ENGENDERED A CALL BY PROMINENT PERSONS FOR HIS SACKING. HIS RESPONSE TO THE LATEST SUCH CALL WAS DESCRIBED BY A GOVERNMENT SPOKESMAN AS "UNPRINTABLE".

8. TO JUDGE FROM PAST PERFORMANCE, THE GOVERNMENT INFORMATION SERVICE WILL NOT BE ABLE TO RETIREVE THE GOVERNMENT'S IMAGE. THE SERVICE HAS BEEN UNDER SHARP ATTACK FROM THE PRESS FOR OOZING OUT BLANDLY CHEERFUL RELEASES IN THE FACE OF PATENTLY ADVERSE DEVELOPMENTS. THE SERVICE RECEIVED A BLACK EYE WHEN, THROUGH NO FAULT OF ITS OWN, IT INCLUDED A KNIGHTHOOD ON THE NEW YEAR'S HONORS LIST THAT HAD NOT, IN FACT, BEEN BESTOWED. MORE BASICALLY, THE SERVICE WILL NOT BE ABLE TO HELP THE GOVERNMENT BECAUSE DEPARMENT HEADS HAVE ANTEDILUVIAN CONCEPTS OF PUBLIC RELATIONS, ARE CONTEMPTUOUS OF THE PUBLIC'S ABILITY TO GRASP THEIR HIGHER CONFIDENTIAL

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TRUTHS, AND QUITE SIMPLY REFUSE TO PASS ON NECESSARY AND USEFUL INFORMATION TO THE SERVICE.

9. GOVERNMENTS HAVE BEEN ABLE TO EXIST FOR LONG PERIODS IN THE PAST WITH BAD IMAGES: THE VENETIAN REPUBLIC WAS NOT EXTINGUISHED UNTIL 1801. THERE WILL BE IMAGE PROBLEMS IN HONG KONG, BUT THE HKG WILL PROBABLY BE ABLE TO LIMP ALONG UNTIL THE INVISIBLE HAND RESTORES PROSPERITY TO THE

COLONY.

10. A POLITICAL ASSESSMENT FOLLOWS BY SEPTTEL.
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